In the Supreme Court of the United States

October Term, 1979

No. 79-878

WESTMORELAND HOSPITAL ASSOCIATION, a non-profit corporation, LATROBE AREA HOSPITAL, a non-profit corporation, THE ALTOONA HOSPITAL, a non-profit corporation, THE HAMOT MEDICAL CENTER OF ERIE, PENNSYLVANIA, a non-profit corporation, MEADVILLE CITY HOSPITAL, a non-profit corporation, SAINT VINCENT HEALTH CENTER, a non-profit corporation, COMMUNITY MENTAL HEALTH CENTER OF BEAVER COUNTY, a non-profit corporation, SOUTH HILLS HEALTH SYSTEM, a non-profit corporation, and HENRY CLAY FRICK COMMUNITY HOSPITAL, a non-profit corporation,

Plaintiffs-Petitioners,

v.

BLUE CROSS OF WESTERN PENNSYLVANIA, a non-profit corporation,

Defendant-Respondent.

Petitioners' Reply To Respondent's Brief In Opposition To The Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

Raymond G. Hasley
ROSE, SCHMIDT, HASLEY, WHYTE & HARDESTY,
900 Oliver Building
Pittsburgh, Pennsylvania 15222
412-434-8600

B. Patrick Costello
COSTELLO & BERK
15 North Main Street
Greensburg, Pennsylvania 15601
412-834-2100

H. Reginald Belden, Jr.
STEWART, BELDEN, HERRINGTON AND BELDEN
100 North Main Street
Greensburg, Pennsylvania 15601
412-834-0300

Counsel for Petitioners

Financial Press Corporation, Pittsburgh

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PETITIONERS' REPLY TO RESPONDENT'S REASONS FOR DENYING THE WRIT

At page 15 of its Brief In Opposition to Petitioner-Hospitals' Petition for a Writ of *Certiorari*, Respondent (hereinafter "Blue Cross") summarized its contentions as follows:

> "...(i) the Federal Statute does not purport to control the reimbursement practices of a third party payor such as Blue Cross or in any way prohibit the deduction of the Federal Staffing Grants in computing cost reimbursement; (ii) the Federal Regulations and HEW's instructional materials expressly set forth the sole test for determining compliance with the 'supplement not supplant' provision of the Federal Statute; (iii) each Petitioner Hospital complied with such test even though Blue Cross deducted the Federal Staffing Grants in computing Blue Cross' reimbursement; and (iv) under Blue Cross' reimbursement formula, the Hospitals' practice of charging below cost for outpatient mental health services has caused Blue Cross to subsidize the Hospitals' mental health programs even though Blue Cross deducted the Federal Staffing Grants in determining reimbursable costs."

Of the foregoing contentions, it is believed that only (ii), (iii) and (iv) merit reply for the reason these contentions are not discussed in the Hospitals' Petition and the contentions confuse or obscure the real issue which the Hospitals seek to have reviewed.

Blue Cross's contentions (ii) and (iii), that the federal regulations and HEW instructional materials set forth in 42 C.F.R. ¶54.302(c)[1] comprise the *sole* test for determining compliance with the "supplement not supplant" provision of

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[1]See Blue Cross's Brief in Opposition, App. G, page 1a.

the federal statute, 42 U.S.C. §2688,[2] and that no supplanting has occurred, are irrelevant. The District Court correctly recognized the inapplicability of the regulation to Blue Cross by stating, at page 33a of the Hospitals' Petition, "The CMHC Policy and Standards Manual and the Federal Regulations, 42 C.F.R. ¶54.302(c), make no reference to the deduction of staffing grants by third party payors." Paragraph 54.302(c) only provides the test (referred to as the "maintenance of effort" test) to determine whether there is or has been a "decline in State financial support" of mental health services. An examination of the regulation provides no support for Blue Cross's argument that if state financial aid to a hospital does not decline, *ergo*, Blue Cross's practice of deducting federal funds does not violate Section 2688. Blue Cross's argument simply does not follow.

Section 2688 speaks not only to the requirement that state and local funds not supplant federal funds, but that the federal funds *supplement* state, local and non-federal funds, "including third party health insurance payments." Hence, paragraph 54.302(c) assures that there will be no decline in the amount of financial support from a state government. However, compliance with the regulation by a state government cannot possibly cure a deviation from Section 2688 by an independent private health insurer. The District Court did not conclude, as indeed it could not, that the Hospitals' ordinary funds would be supplemented if Blue Cross could deduct the federal funds. The flaw in that argument should be apparent. To absolve a private health insurer like Blue Cross from its reimbursement obligation because of benefits received by a hospital from a state government—or from any other party—would be analagous to absolving a tortfeasor from liability for damages because the injured person has received compensation from a third party. This argument has long been rejected. The financial aid a hospital receives from a state government should not inure to the economic benefit of a third-party health insurer, and the expression of this Congressional policy is believed crystal clear in Section 2688.

[2]See Hospitals' Petition, App. B, page 3a.

In any event, assuming state aid does not decline, the test that federal grants *supplement* other funds can never be met by a third-party health insurer when its payments are less than they would otherwise be by virtue of its deduction of the grants, regardless of the grantee's success in raising funds from other sources. Thus, the Hospitals' compliance with the test of Paragraph 54.302(c) pertaining to state aid has no bearing on a violation of Section 2688 by a private health insurer.

Blue Cross's contention(iv), that it has subsidized the hospitals' mental health program even though it has deducted the grants, is likewise fallacious and irrelevant.[3] The argument is bottomed on the admitted fact that in some cases the gross income from the operations of a particular department within a hospital may be less than that hospital's actual cost of operations for that department. That loss, hopefully, is made up by a surplus produced by other departments. This is true not only of hospitals, but of any business. Some departments or products may be more costly or less profitable than others. However, it is the performance of the company as a whole that determines its profitability. However, hospitals are unlike other businesses in at least one

[3]The District Court at 35a-36a of the Petition refers to a letter signed by Sister Margaret Ann Hardner of Saint Vincent Health Center as proof that Blue Cross subsidized the Hospitals' mental health programs. However, at trial it was shown that the letter was not written by Sister Margaret Ann Hardner but by Mr. Robert Cox, Treasurer of Saint Vincent's, who explained that he was merely stating *Blue Cross's* argument (See pages 1436a-1453a of the Appendix filed in the Court of Appeals). With all due respect to the District Court, the Hospitals believe that the District Court misinterpreted the letter.

very important respect. Whereas a run-for-profit business is free to sell, phase out or otherwise rid itself of an unprofitable element of its business, hospitals are not free to operate on a profit-maximizing philosophy. Hospitals are non-profit—the medical needs of the community must be met even though any one service may not be as profitable as another.

A hospital's alternatives are thus: (1) to make unprofitable departments profitable by raising the amounts charged to patients who utilize the less profitable services, even if this sends medical costs spiralling, perhaps beyond the ability of patients to pay; or (2) to cease offering the unprofitable services altogether. This is precisely the dilemma Congress sought to avoid when it voted to establish a program of funding for community mental health centers.

Furthermore, even if Blue Cross is indirectly "subsidizing" unprofitable hospital services in some instances, it has not been singled out. All patients receiving these services are charged the same rate—both those covered by Blue Cross and those not covered. Indeed, Blue Cross even receives a "break" from the Hospitals on its payments. By contract, Blue Cross is protected from being required to pay excessive sums for services to its subscribers, since its maximum liability is limited either to the Hospitals' regular charges for services to patients or to a *per diem* rate based upon cost reimbursement, whichever is less. If Blue Cross elects to pay regular charges for its subscribers, it could, in fact, take advantage for its subscribers of the alleged undercharging in mental health departments and it would pay no more for services in other departments than other insured or uninsured persons. Thus, Blue Cross could settle with the hospitals without regard to the profit or loss from the operation of a community mental health center. Since Blue Cross obviously elects the least costly method of payment, its election to pay on the basis of cost reimbursement rather than on the basis of regular charges refutes any assertion that it subsidizes the mental health programs.

Ironically, the Blue Cross practice of applying federal grants as an offset against reimbursable costs results in Blue Cross being subsidized by the federal government. The Blue Cross cost reimbursement agreement (even without deducting federal grants) regularly results in a savings to Blue Cross of 10 to 20% of the charges paid by other private health insurers or uninsured persons.

The subsidy to Blue Cross by deducting the grants is illustrated by the situation of Community Mental Health Center of Beaver County. Beaver was opened January 1970. The clinic was built through funds available under the community mental health center legislation and it received the benefits of the staffing grant phase of the program beginning in September 1970. The Medical Center of Beaver County (formerly Rochester General Hospital) had signed a charter with the Beaver County Mental Hygiene Clinic to sponsor it for such funding, but it also had a separate charter as a free-standing clinic.

Beaver signed the 1966 Blue Cross contract in March 1970, and the contract took effect retroactively to January 1970. Based on information supplied to Blue Cross by the mental health center officers, a *per diem* rate of $41.12 to cover costs was initially established. Blue Cross gave no indication at this point that it intended to deduct the mental health staffing grants (see page 601a of the Appendix filed in the Court of Appeals). However, at the end of the fiscal year 1970-71, Blue Cross deducted the mental health staffing grant and reduced Beaver's *per diem* rate to $27.53 or $13.59 below cost because of the grants. Thus, a share of the grant flowed to Blue Cross.

Further, it is the fact that for every one dollar saved by cost reimbursement payors, such as Blue Cross, its competitors and uninsured persons are likely to pay an additional four dollars. Since the cost reimbursement agreements do not provide the margin of operating revenue actually required by the Hospitals, Blue Cross's competitors and uninsured persons must take up the slack left by the minimum costs paid by Blue Cross, Medicare and Medicaid.

(See pages 792a-797a of the Appendix filed in the Court of Appeals.)

Thus, in truth, Blue Cross's competitors and uninsured patients must pay more because Blue Cross pays less; and, if any persons subsidize health care, it is Blue Cross's competitors and uninsured patients and not Blue Cross.

CONCLUSION

The contentions of Blue Cross simply do not address the basic issue: whether any agreement, scheme or device to divert the benefits provided by Congress for the mental health program, is void as contrary to the clearly enunciated policy that federal grants are to *supplement* non-federal funds. Petitioner Hospitals respectfully request that this Court accept jurisdiction of this case to review the rulings of the Court of Appeals and the District Court, since these rulings conflict with an important Congressional program.

Respectfully submitted,

RAYMOND G. HASLEY, ESQ.
ROSE, SCHMIDT, DIXON,
HASLEY, WHYTE & HARDESTY
900 Oliver Building
Pittsburgh, Pennsylvania 15222
412-434-8600

B. PATRICK COSTELLO, ESQ.
COSTELLO & BERK
15 North Main Street
Greensburg, Pennsylvania 15601
412-834-2100

H. REGINALD BELDEN, JR., ESQ.
STEWART, BELDEN, HERRINGTON
AND BELDEN
100 North Main Street
Greensburg, Pennsylvania 15601
412-834-0300

Counsel for Petitioners